

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

CONTRACTING OFFICER PRICE ANALYSIS

Report No. 97-207

August 26, 1997

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Acronyms

| | |
|------|-------------------------------------|
| DCMC | Defense Contract Management Command |
| FAR | Federal Acquisition Regulation |
| FPRA | Forward Pricing Rate Agreement |
| FPRR | Forward Pricing Rate Recommendation |



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**



August 26, 1997

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
AND TECHNOLOGY**

DIRECTOR, DEFENSE PROCUREMENT
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on Contracting Officer Price Analysis (Report No. 97-207)

We are providing this audit report for your information and use. We considered management comments on a draft of this report when preparing the final report. The audit was performed as a follow-up to Inspector General, DoD, Audit Report No. 94-004, "Contracting Officer Price Analysis," October 15, 1993, to determine whether DoD contracting officers were effectively using price analysis techniques.

As a result of management comments, we revised Recommendation 1., redirected Recommendation 2., and deleted Recommendation 3. Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Garold E. Stephenson, Audit Program Director, at (703) 604-9332 (DSN 664-9332) or Mr. Charles M. Hanshaw, Audit Project Manager, at (703) 604-9256 (DSN 664-9256). See Appendix G for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report 97-207
(Project No. 7CH-5004)

August 26, 1997

Contracting Officer Price Analysis

Executive Summary

Introduction. The audit was performed as a follow-up to Inspector General, DoD, Audit Report No. 94-004, "Contracting Officer Price Analyses," October 15, 1993. During FY 1996, the 12 procurement and contract administration offices reviewed in the 1993 audit awarded and administered about 2,450 noncompetitive, negotiated contract actions, priced from \$100,000 to \$500,000 and valued at \$590 million.

Audit Objectives. The audit objective was to determine whether contracting officers were complying with the Federal Acquisition Regulation requirement to use price analysis techniques to evaluate prices in contract proposals. Specifically, we determined whether price analysis techniques were appropriately used, adequately detailed, and properly documented and whether certified cost or pricing data were requested only when required. The audit also evaluated the adequacy of management control programs as they applied to the audit objective.

Audit Results. Management emphasis on the increased use of price analysis techniques contributed to improved compliance with the Federal Acquisition Regulation on price analysis performance. The 12 procurement and contract administration offices increased the use of price analysis after the 1993 audit. The prior audit determined that the 12 offices used price analysis techniques for 61 (52.6 percent) of the 116 reviewed contract actions priced from \$100,000 to \$500,000 and valued at \$14.3 million (51.7 percent of the \$27.7 million value of the 116 reviewed contract actions). The current audit determined that the 12 offices used price analyses for 74 (68.5 percent) of the 108 contract actions in the same price range and valued at \$20.5 million (70 percent of the \$29.3 million value of the 108 contract actions reviewed). Although the 12 offices increased their use of price analyses, 9 of the 12 offices still did not perform required price analyses or did not justify decisions to avoid the price analyses for 24 of 108 reviewed contract actions valued at \$6.1 million. As a result, contractor and Government resources were not used economically when cost or pricing data were provided and cost analyses were performed for actions valued at less than \$500,000.

Recommendations. We recommend that the Service Acquisition Executives and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to:

- perform price analyses instead of using Defense Contract Audit Agency recommended rates, technical analysis, or field pricing support reports to evaluate contract proposal prices, except for the limited circumstances in FAR 15.8; and
- document any price analysis performed in price negotiation memorandums.

Management Comments: We received comments on the draft of this report from the Acting Deputy Assistant Secretary of the Army (Procurement), the Principal Deputy Assistant Secretary of the Navy (Research, Development, and Acquisition), the Deputy Assistant Secretary of the Air Force (Contracting), the Principal Deputy Director of the

Defense Logistics Agency, and the Assistant Director of Policy and Plans, Defense Contract Audit Agency. The Army, Navy, Air Force, and Defense Logistics Agency agreed to reemphasize policy and regulatory requirements on price analysis for proposal prices from \$100,000 to \$500,000 and to document price analysis performed in price negotiation memorandums. Based on comments provided by Army, Navy, Air Force, and Defense Logistics Agency, we withdrew the draft report recommendation requiring contracting officers to instruct contractors to provide cost or pricing data and other pricing information only when requested. See Part I for a summary of management comments and Part III for the complete text of management comments.

Audit Response. We consider the comments provided by the Army, Navy, Air Force, and Defense Logistics Agency to be responsive.

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Part I - Audit Results

Audit Background

Price Analysis. Price analysis is the process of examining and evaluating a contractor's proposed price without analyzing the proposal cost elements and profit. Price analysis techniques include comparing contractors' proposed prices with marketplace prices, historical contract prices for the same or similar items, commercial catalogs, and independent Government cost estimates. Federal Acquisition Regulation (FAR) 15.805-2, "Price Analysis," states that the contracting officer is responsible for selecting and using whatever price analysis techniques ensure an overall fair and reasonable price for the Government. The use of price analysis techniques is mandatory for contractor proposals valued from \$100,000 to \$500,000.

Cost Analysis. Cost analysis is the evaluation of each separate cost element and profit in a contractor proposal to prove the reasonableness of the pricing arrangement offered. FAR 15.804-2, "Requiring Cost or Pricing Data," states that the threshold for obtaining cost or pricing data is \$500,000. FAR 15.804-1, "Prohibition on Obtaining Cost or Pricing Data," provides exceptions to the cost or pricing data requirements. Cost analysis is usually required for all contractor proposals greater than \$500,000. However, contracting officers should perform a price analysis to ensure that the overall price offered is fair and reasonable. In the context of the current FAR, the term "cost or pricing data" refers to certified cost or pricing data in accordance with FAR 15.804-4. All subsets, including "uncertified cost or pricing data," are considered to be information other than cost or pricing data.

Information Other Than Cost or Pricing Data. FAR 15.804-5, "Requiring Information Other Than Cost or Pricing Data," states that if cost or pricing data are not required because a contract action is at or below the cost or pricing data threshold, the contracting officer shall make a price analysis to determine price reasonableness and need for further negotiation. In addition, FAR 15.804-5(a)(2) states that the contracting officer may require the submission of information other than cost or pricing data* only to the extent necessary to determine reasonableness of the price or cost realism. Public Law 103-355, "Federal Acquisition Streamlining Act of 1994," section 1203, prohibits contracting officers from requesting certified cost or pricing data if an exception is obtainable.

*Information other than cost or pricing data includes "uncertified cost or pricing data."

Audit Objectives

The overall audit objective was to determine whether contracting officers complied with the FAR requirement to use price analysis techniques to evaluate prices in contract proposals. Specifically, we determined whether contracting officers appropriately performed, adequately detailed, and properly documented price analysis and whether certified cost or pricing data were requested only when required. The audit also evaluated the adequacy of management control programs as they applied to the overall audit objective.

The audit was performed at the same 12 Army, Navy, Air Force, and Defense Logistics Agency procurement and contract administration offices covered by Inspector General, DoD, Audit Report No. 94-004, "Contracting Officer Price Analyses," October 15, 1993. See Appendix A for a discussion of the scope, methodology, and management control program and Appendix B for a summary of prior audit coverage related to the audit objective.

Use of Price Analysis

Management emphasis on the increased use of price analysis techniques contributed to improved price analysis performance. The 12 procurement and administration contracting offices increased the use of price analysis after the 1993 audit. The offices performed and documented price analysis for 68.5 percent of the contract actions and for 70 percent of the dollars reviewed during the current audit, compared to only 52.6 percent of the contract actions and 51.7 percent of the dollars reviewed during the prior audit. Although the 12 offices increased their use of price analysis, 9 of the 12 offices still did not perform required price analysis or did not justify decisions to avoid the price analysis for 24 of 108 contract actions reviewed, valued at \$6.1 million. For the 24 contract actions for which price analysis was not performed or documented, contracting officers relied on Defense Contract Audit Agency recommended rates, incurred costs, technical analysis, or field pricing support reports rather than price analysis. As a result, contractor and Government resources were not used economically when cost or pricing data were provided and cost analyses were performed for actions less than \$500,000.

Comparison of Prior and Current Audit Results

Report No. 94-004 determined that for 116 contract actions priced from \$100,000 to \$500,000, valued at \$27.7 million, the 12 procurement and contract administration offices did not:

- maintain documentation that evidenced price analysis for 55 contract actions valued at \$13.3 million, and
- adequately document price analysis in the Government negotiation memorandums for 24 contract actions valued at \$5.3 million.

The current audit determined that for 108 FY 1996 contract actions in the same price range, valued at \$29.3 million, the 12 procurement and contract administration offices did not maintain documentation that evidenced price analysis for 24 actions, valued at \$6.1 million. Appendix C provides details on the offices, contract numbers, and values of contract actions reviewed and the current audit results. Appendix D provides details on the individual contract actions that contained analysis deficiencies.

Table 1 shows the comparison of contract actions reviewed in the prior and current audits and the deficiencies noted.

Table 1. Comparison of Contract Actions

| | Prior Audit | | Current Audit | |
|---|-------------|--------------|---------------|--------------|
| | Actions | Values | Actions | Values |
| Contract Actions Reviewed | 116 | \$27,654,012 | 108 | \$29,289,986 |
| Price Analysis Not Performed | 55 | 13,348,040 | 24 | 6,134,267 |
| Price Analysis Not Performed But Justified | 0 | 0 | 10 | 2,662,984 |
| Price Analysis Not Documented | 24 | 5,320,103 | 32 | 8,990,423 |
| Cost Analysis Basis of Negotiation Objective | 88 | 19,979,925 | 48 | 12,586,498 |

Price Analysis

Price Analysis Techniques. Price analysis techniques used to evaluate contract proposals should depend on the complexity and anticipated dollar value of acquisitions. The prior audit determined that the 12 offices used price analysis techniques to establish price reasonableness for 61 (52.6 percent) of the 116 contract actions costing from \$100,000 to \$500,000 and valued at \$14.3 million (51.7 percent of the \$27.7 million reviewed). The current audit determined that the 12 offices used price analysis for 74 (68.5 percent) of the 108 contract actions in the same price range, valued at \$20.5 million (70 percent of the \$29.3 million reviewed). Table 2 shows a comparison of the quantities and values of contract actions, by DoD Components, for which price analysis techniques were used.

Table 2. Comparison of Price Analysis Techniques Used

| | Prior Audit | | Current Audit | |
|--------------------------|------------------|----------------------|------------------|----------------------|
| | Actions | Values | Actions | Values |
| Army | 8 of 11 | \$ 2,033,210 | 19 of 23 | \$ 5,108,381 |
| Navy | 28 of 33 | 6,450,175 | 24 of 30 | 7,608,103 |
| Air Force | 4 of 12 | 891,973 | 7 of 10 | 1,556,337 |
| Defense Logistics Agency | 21 of 60 | 4,930,614 | 24 of 45 | 6,219,914 |
| Totals | 61 of 116 | \$ 14,305,972 | 74 of 108 | \$ 20,492,735 |

The Military Departments and the Defense Logistics Agency increased the use of price analysis since the 1993 audit, as shown in Tables 1 and 2. Contracting officers at all 12 procurement and contract administration offices visited in the current audit had been trained in the FAR and Armed Services Pricing Manual guidance on price analysis. However, 15 of 23 contracting personnel

Use of Price Analysis

interviewed at the Defense Contract Management Command (DCMC) Hughes, Los Angeles, California, were not knowledgeable of the price analysis techniques available to evaluate contractor proposals. Thus, they performed a cost analysis for every contract action, regardless of dollar value, believing that the terms "price analysis" and "cost analysis" were interchangeable.

Independent Government Cost Estimate. Although the FAR does not require independent Government cost estimates, those estimates are one of the contracting officer's primary tools in evaluating a proposal. An independent Government cost estimate is an in-house estimate of the probable price of a proposed acquisition and should be prepared before issuing a solicitation. The Army Missile Command and the Air Force Aeronautical Systems Center developed independent Government cost estimates, in addition to historical price comparisons. The Supervisor of Shipbuilding, Conversion, and Repair, San Diego, California, effectively used independent Government cost estimates for 11 contract actions, valued at \$2.7 million, to negotiate prices that averaged about 21 percent less than contractors' proposed prices. Seven other contracting organizations relied on historical price comparisons, published price comparisons, competitive price comparisons, or intrinsic value analyses rather than independent Government cost estimates.

An independent Government estimate is a good price analysis technique if program personnel carefully prepare the estimates by performing physical inspections and have available data on previous work requirements. This technique is appropriate when the contracting officer cannot rely on a historical price comparison because of significant price increases or when common sense indicates that the contractor-proposed price is not reasonable. However, contracting officers need to convince program managers of the need for accurate estimates so that a high priority is assigned to the independent Government estimate preparation.

Value Analysis Technique. Value analysis provides insight on the inherent worth of an item through evaluation of functions that the item performs. This estimating technique is appropriate to use when a contracting officer is attempting to decide whether the product, as it is currently made, is the best product in terms of value. A value analysis seeks to ensure that an item does not necessarily exceed the Government's minimum requirements. The DCMC Northrop, Hawthorne, California, used value analysis techniques for 10 contracts, valued at \$2.8 million, of the 12 contracts reviewed. DCMC Northrop was the only contracting organization visited that used value analysis techniques and historical price comparisons to evaluate contractor-proposed prices. Value analysis, like an independent Government estimate, is a useful tool in contract negotiations and requires physical inspection of the item and data on consumption of items or previous work requirements.

Catalog Pricing Technique. The FAR states that it is the contracting officer's responsibility to use whatever price analysis technique that ensures an overall fair and reasonable price. Contracting officers may use established catalog prices currently or last made available to a significant number of buyers that constitute the general public. Catalog prices are normally included in a catalog, price list, schedule, or other form that is regularly maintained by the

manufacturer or vendor and made available for inspection by prospective customers. Contracting officers at the Army Aviation and Troop Command, the Air Force Aeronautical Systems Center, and the Defense Personnel Support Center used established catalog prices to evaluate prices proposed for 10 of the 27 contract actions reviewed, valued at \$2.9 million.

Price Analysis Performance. Of the 12 procurement and contract administration offices reviewed, 9 did not perform required price analysis or did not justify decisions to avoid the required price analysis for 24 contract actions, negotiated at \$6.1 million. Price negotiation memorandums for the 24 contract actions showed that contracting officers relied on Defense Contract Audit Agency recommended rates, incurred costs, technical analysis, or field pricing support reports rather than price analysis. These techniques are acceptable to use if additional information is needed to determine price reasonableness or cost realism. However, the techniques should not be used as a substitute for price analysis for proposed contracts valued from \$100,000 to \$500,000.

Defense Contract Audit Agency Rates. Contracting officers are not relieved from FAR and Defense FAR Supplement price analysis requirements when the officers obtain Defense Contract Audit Agency recommended rates. Contracting officers relied on Defense Contract Audit Agency recommended rates to evaluate prices in contractor proposals and to establish negotiation objectives for seven contract actions reviewed, valued at \$1.9 million. We found no evidence that the contracting officers performed any price analyses. For example, the business clearance memorandum for Naval Sea Systems Command contract modification N00024-94-C-4104-P00004, valued at \$387,000, contained a section for the contracting officer to describe the price analysis techniques used. However, the contracting officer did not describe the price analysis performed. Contracting officers should either document the price analysis that was performed or provide a justification for why price analysis was not performed.

Contract Definitization. Contracting officers at four DCMC contractor sites relied on incurred cost data to determine that prices were fair and reasonable. The contracting officers did not definitize 11 contract actions, valued at \$2.6 million, within the required 180 days of issuance of the unpriced contractual action. The lack of timely definitization was due, in part, to a DCMC reorganization and to untimely contract proposals. By the time the unpriced contractual actions were negotiated, all or most of the contract costs were incurred. Contracting officers should use price analysis techniques to verify that the incurred costs are reasonable.

Technical Analysis and Field Pricing Reports. Rather than using price analysis to establish negotiation objectives for five contract actions, valued at \$1.5 million, contracting officers requested technical analysis and field pricing reports. The contracting officers should have performed a price analysis to establish the Government's negotiation objective or should have justified their

Use of Price Analysis

decision not to perform the price analysis. FAR 15.805-4, "Technical Analysis," and FAR 15.805-5, "Field Pricing Support," do not relieve contracting officers from performing price analysis when a technical analysis or field pricing report is obtained. Those reports are generally used when certified cost or pricing data are required.

Price Analysis Documentation. Report No. 94-004 recommended that procurement and contract administration offices document price analysis results in a separate section of price negotiation memorandums. The current audit determined that the 12 offices established procedures to implement the recommendation, but only 4 offices, the Army Aviation and Troop Command; Naval Sea Systems Command; Navy Supervisor of Shipbuilding, Conversion, and Repair; and Aeronautical Systems Center, consistently documented price analysis results in the prescribed sections of the negotiation memorandums. The other 8 offices did not document price analysis results in negotiation memorandums for 32 contract actions, valued at \$9 million. The contracting officers at the eight offices need to document price analysis in price negotiation memorandums.

Price Analysis Training. Report No. 94-004 recommended restructuring of training requirements to emphasize price analysis performance and documentation requirements. In response to the recommendation, the Defense Contracting Career Management Board and the Defense Acquisition University restructured basic and intermediate contract pricing courses and reemphasized the need for senior-level continuing education.

The revised basic contract pricing course, implemented in FY 1993, includes a review of the contracting environment's sources of data for cost and price analysis, methods for analyzing direct and indirect costs, methods for performing profit analysis, ethics in contract pricing, and selection of current pricing topics. Individual and group negotiation workshops address the fundamentals of the negotiation process, including essential techniques, strategies, and tactics. An actual cost analysis is used to illustrate and integrate the various concepts and methods covered in the course.

The intermediate contract pricing course, implemented in FY 1994, reinforces pricing skills taught in the basic course and develops skills in performing more advanced pricing duties. The four areas of concentration within the course are: quantitative methods for cost and price analysis, advanced pre-award pricing decisions, post-award pricing decisions, and general contract pricing issues. All contracting officials at the 12 procurement and contract administration offices had received training and certification in contract pricing from the Defense Acquisition University.

Since the restructure of the basic and intermediate contract pricing courses, there has been significant improvement with contracting officers' use of price analysis.

Cost Analysis

The 1993 audit determined that 10 of the 12 procurement and contract administration offices based negotiation objectives for 88 (76 percent) of the 116 contract actions primarily on cost analysis rather than on price analysis. The current audit determined that 9 of the offices based negotiation objectives for 48 (44 percent) of the 108 contract actions reviewed on cost analysis. Although the offices improved since 1993, three offices, DCMC Atlanta, Georgia; DCMC El Segundo, California; and DCMC Hughes continued to use cost analysis as the primary basis for negotiation objectives.

Cost Analysis Performance. The scope and depth of the analysis supporting the Government's negotiation objective should be directly related to the dollar value, importance, and complexity of the pricing action. Contracting officers should consistently prepare adequate justification in negotiation memorandums for relying on cost analysis. Cost analysis is normally necessary when cost or pricing data are required. Contracting officers at 9 offices did not justify cost analysis performed for 26 of 48 contract actions reviewed, valued at \$6.7 million. Negotiation memorandums prepared by contracting officers for the other 22 contract actions, valued at \$5.8 million, contained sufficient justification for reliance on cost analysis to determine price reasonableness.

Forward Pricing Rate Agreements and Recommendations. Contracting officers at the Aeronautical Systems Center, DCMC El Segundo, and DCMC Hughes properly used forward pricing rate agreements (FPRAAs) or forward pricing rate recommendations (FPRRs) for negotiation objectives for 13 contract actions, valued at \$3.3 million. According to the Defense FAR Supplement 215.809, "Forward Pricing Rate Agreements," contracting officers shall use FPRAAs or recommended rates when such rates are available. An FPRA is a written agreement negotiated between a contractor and the Government to make certain rates for labor, indirect cost, spare parts provisioning, or material handling available during a specified period for use in pricing contracts and modifications. An FPRR is a rate set unilaterally by the administrative contracting officer to use when FPRA negotiations are not complete or when the contractor does not agree to an FPRA.

Certified Cost or Pricing Data. The prior audit determined that contracting personnel were not always aware that the threshold for certified cost or pricing data had increased from \$100,000 to \$500,000. As a result, contracting personnel requested certified cost or pricing data from contractors for 32 of 116 actions valued at less than \$500,000 each, although only 7 of the 32 actions justified the need for certified cost or pricing data.

The current audit determined that contracting officers usually requested certified cost or pricing data only when required. Contracting officers justified 17 of 21 requests for certified cost or pricing data for 108 contract actions reviewed, valued from \$100,000 to \$500,000 and totaling \$5.5 million. However, contractors provided certified cost or pricing data for 3 contract actions, valued at \$732,704 and other cost or pricing information for 38 contract actions, valued at \$10.1 million, when not requested by contracting officers. The

Use of Price Analysis

provision of unnecessary data increases contractor overhead costs, which are normally charged to the Government. Contracting organizations should inform contractors that the DoD preferred pricing process is to use data other than cost or pricing data to evaluate contract proposals valued from \$100,000 to \$500,000 and that cost or pricing data should be provided only when requested by contracting officers.

Summary

Since the 1993 audit, the increased emphasis on contracting officers' use of price analysis has resulted in increased use of price analysis techniques instead of detailed cost analysis. The number and dollar value of actions requiring but not supported by documented price analysis has declined at the 12 procurement and contract administration offices. The majority of the contracting officers at the 12 offices have an increased knowledge of the appropriate use of price analysis techniques and the need to place greater reliance on price analysis results to evaluate contract proposals. Additional emphasis by the Service Acquisition Executives and the Director, Defense Logistics Agency, can further improve contracting officer price analysis and reduce procurement administrative costs.

Recommendations, Management Comments, and Audit Response

Revised, Redirected, and Deleted Recommendations. Based on management comments, we revised Recommendation 1. to clarify that information (such as Defense Contract Audit Agency recommended rates, technical analysis, or field pricing assistance) should be used in the limited circumstances cited in FAR 15.8 to support price analysis. We redirected Recommendation 2. to the Army, Navy, and Defense Logistics Agency because the audit did not identify any discrepancies at the Air Force contracting organization visited. We deleted Recommendation 3. due to FAR 15.802 limitation on information a contracting officer may obtain or request.

- 1. We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director of Defense Logistics Agency issue guidance to their contracting organizations reminding contracting officers of the policy to perform price analysis instead of using information such as Defense Contract Audit Agency recommended rates, technical analysis, or field pricing assistance to evaluate contract proposal prices from \$100,000 to \$500,000, except for the limited circumstances cited in FAR 15.8.**

2. We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); the Assistant Secretary of the Navy (Research, Development, and Acquisition); and the Director of Defense Logistics Agency include a requirement in the guidance in Recommendation 1. that contracting officers are to document price analysis performed in price negotiation memorandums.

Army Comments. The Army stated that contracting officers would be reminded of the requirement to perform a price analysis; to use information other than cost or pricing data in conjunction with, and not in place of, price analysis; and to document price analysis in negotiation memorandums.

Navy Comments. The Navy stated that policy guidance has been issued reminding contracting activities of the regulatory requirements to perform a price analysis instead of using Defense Contract Audit Agency recommended rates, technical analysis, or field pricing support reports; and to document price analysis in negotiation memorandums.

Air Force Comments. The Air Force concurred with the intent of draft report Recommendation 1., stating that a memorandum would be issued to remind contracting officers of the order of the hierarchical policy preference at FAR 15.802 for a determination regarding price reasonableness.

Defense Logistics Agency Comments. The Defense Logistics Agency partially concurred with draft report Recommendation 1. and concurred with draft report Recommendation 2., stating that a letter would be issued reminding Administrative Contracting Officers of the Agency requirement to perform a price analysis for every contract regardless of dollar value and to document price analysis performed in price negotiation memorandums.

Defense Contract Audit Agency Comments. Although not required to comment, the Defense Contract Audit Agency partially agreed with Recommendation 1., stating that most pricing actions from \$100,000 to \$500,000 should be evaluated using price analysis. However, cost analysis and DCAA recommended rates are allowed as tools in the limited circumstances cited in FAR 15.805-5(b).

Audit Response. We recognize that FAR 15.8 provides limited circumstances which contracting officers can use information other than price analysis to determine proposal price reasonableness for proposal prices from \$100,000 to \$500,000. However, information such as Defense Contract Audit Agency recommended rates, technical analysis, or field pricing assistance should not be substituted for price analysis in the normal course of evaluating price reasonableness. The Army, Navy, Air Force, and Defense Logistics Agency comments met the intent of the revised recommendations.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Universe and Sample Information. We used the Defense Contract Action Data System maintained by Washington Headquarters Services and databases maintained by the Defense Contract Management Command to identify a universe and sample of contract actions for review. We judgmentally selected 108 FY 1996 noncompetitive, negotiated contract actions, ranging in value from \$100,000 to \$500,000, with a total negotiated value of \$29.3 million. The actions were negotiated by the 12 Army, Navy, Air Force, and Defense Logistics Agency procurement and contract administration offices that were discussed in Inspector General, DoD, Audit Report No. 94-004, "Contracting Officer Price Analyses," October 15, 1993.

Because of the incomplete information and errors in Defense Contract Action Data System data, we were unable to project DoD-wide audit results. Therefore, the audit results presented in this report are the analysis of attributes based only on the 108 contractual actions reviewed.

Computer-Processed Data. We relied on computer-processed data from the Defense Contract Action Data System and Defense Contract Management Command databases to determine audit sample selection. We did not perform a formal reliability assessment of the computer-processed data because the audit of Undefined Contractual Actions (Report No. 97-204) determined that the data recorded in the Defense Contract Action Data System were inaccurate and incomplete. However, when the sampled data from the system and databases were reviewed in context with official contract records, we determined that the opinions, conclusions, and recommendations in this report are valid.

Review of Documentation. At the 12 procurement and contract administration offices, we reviewed documentation related to FY 1996 contracts selected for review. The documentation included the contracts, contractor proposals and certifications, technical reports, Defense Contract Audit Agency reports, price analysis reports, prenegotiation memorandums, and postnegotiation memorandums. In addition, we reviewed documents relevant to contracting officer training and management control programs.

Interviews. We interviewed DoD contracting officers, contract administrators, negotiators, and price analysts.

Audit Period and Standards. This economy and efficiency audit was made from September 1996 through May 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary.

Organizations Visited or Contacted. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We evaluated DoD management controls covering the use and documentation of price analysis for selected noncompetitive, negotiated contract actions, including management's self-evaluations. The scope of our review of management risk assessments was limited because only 2 of the 12 procurement and contract administration offices included price analysis as a separate assessable unit. Of the 10 offices that did not have separate assessable units for price analysis, 9 either reviewed or planned to review price analysis as part of an assessable unit for proposal analysis or contracting. One of the ten offices had not reviewed and did not plan to review the area of contractor proposal analysis until management agreed with our suggestion to schedule a management control review of price analysis.

Adequacy of Management Controls. Management controls were adequate in that we identified no material management control weaknesses.

Appendix B. Summary of Prior Audits and Other Reviews

Inspector General, DoD

Report No. 96-035, "Price Challenges on Selected Spare Parts," December 12, 1995. The report states that for 24 spare parts, DoD buying centers paid unreasonable prices because contracting officers did not use available independent Government estimates and field pricing support when determining whether prices were fair and reasonable for 6 parts, analyze price increases over previous procurements for 6 parts, and solicit identified alternative sources for 12 parts. The report recommended that the Commander, Naval Systems Command, and the Director, Defense Logistics Agency, issue guidance to their respective buying centers that requires contracting officers to obtain, when feasible, independent Government estimates for negotiated procurements of spare parts and to use the estimates, including any should-cost estimates, in establishing prenegotiation price objectives. The report also recommended that the guidance require contracting officers to compare previous procurement prices with proposed procurement prices and to evaluate any price increase that common sense indicates is not reasonable. The Navy and the Defense Logistics Agency concurred and initiated corrective action.

Report No. 95-275, "Pacific Air Forces Educational Services Contracts Report," July 5, 1995. The report states that Pacific Air Forces contracting personnel did not adequately document that fair and reasonable prices were negotiated. As a result, Pacific Air Forces did not achieve potential proposal reductions of \$5.2 million for five contracts identified in assist audits and Government estimates. The report recommended that contracting officers emphasize the retention of documentation in contract files to support contract review analysis. The report also recommended that source selection authorities include price reasonableness methodology for future contracts. Management generally concurred and took corrective action.

Report No. 94-004, "Contracting Officer Price Analyses," October 15, 1993. The report states that contracting organizations did not properly perform or adequately document the use of price analysis to determine whether contract proposal prices were fair and reasonable. Also, price analyses were not adequately documented in the Government negotiation memorandums when contracting officers performed price analyses. Those conditions occurred because contracting organizations inappropriately relied on cost analyses in evaluating proposals; needed to strengthen internal controls over price analysis performance and documentation; did not fully comply with regulations covering the proposal evaluation process; did not use various price analysis methods available; and did not provide adequate price analyses training. The Air Force and Defense Logistics Agency agreed to implement the recommendations and took corrective action. The Army and Navy stated that current guidance on price and cost analyses was adequate and that implementing the

recommendations was not needed; however, the Navy agreed to revise the Naval Acquisition Procedures Supplement and distribute it to the Navy organizations.

Report No. 93-105, "Procurement of Spare Parts and Supplies," June 4, 1993. The report states that 32 of 141 spare parts were unreasonably priced. As a result, DoD buying centers overpaid \$621,572 for 32 spare parts, valued at \$1.9 million. The overpricing occurred because buying centers did not perform adequate price analyses or prepare Government price estimates before contract award. The report recommended the issuance of guidance to item managers and contracting officers to obtain independent Government estimates based on engineering analyses for certain items. The report also recommended reporting the results of the Military Departments and Defense Logistics Agency pricing review programs at inventory control points. Management generally concurred with the findings and recommendations. The Deputy Under Secretary of Defense (Logistics) issued a memorandum to the Military Departments and Defense Logistics Agency, October 1, 1993, that requested that pricing be included in audits, inspections, and internal control program reviews. The memorandum also stated that logistic automation efforts should include tools to ensure cost-effective monitoring of spare parts pricing.

Department of the Army

United States Army Audit Agency, Report No. CR 93-3, "Missile Systems' Cost Estimates, Redstone Arsenal, Alabama," January 5, 1993. The report concluded that the Army Missile Command, Redstone Arsenal, Alabama, certification process for making sure that cost estimates were appropriately prepared and reviewed was not fully effective because the process did not include some fundamental internal management controls. Reviews of cost estimates were not made by cost analysts, other than those preparing the estimates. Further, the reviews were not fully documented. Moreover, when a cost analyst did not prepare a cost estimate, a more stringent review was not made. The report recommended that the Missile Command strengthen management controls associated with missile system cost estimates. Management generally agreed with the report recommendations and took corrective actions.

Department of the Navy

Office of the Assistant Secretary of the Navy (Research, Development, and Acquisition), "Procurement Management Review of the Naval Sea Systems Command," August 14, 1992. The report concluded that price analysis is needed on cost-type service contracts and requires more than a comparison of prior years' prices. The report also concluded that the Naval Sea Systems Command dual-source procurements generally contained adequate price

Appendix B. Summary of Prior Audits and Other Reviews

analyses. The Naval Sea Systems Command business clearances typically omitted this useful analysis or contained an inadequate analysis. The report recommended that the Naval Sea Systems Command increase utilization of price analysis in business clearances. The report did not require management comments and none were provided.

Air Force Audit Agency

Report No. 91064045, "Negotiation of Noncompetitive Acquisitions from \$100,000 to \$500,000," July 27, 1992. The report states that Air Force Materiel Command Air Logistics Centers contracting personnel did not accomplish adequate price analyses for 35 of 67 contracts reviewed. As a result, the Air Logistics Centers awarded \$8.4 million in noncompetitive contracts without assurance that the price was fair and reasonable. The problem occurred partly because Air Logistics Center contracting personnel lacked adequate knowledge and training in FAR, Armed Services Pricing Manual, and Air Force Regulation 70-18, "Contracting Pricing," requirements on price analysis. Also, contracting personnel did not review historical pricing information, and management had not established internal controls to verify completion of price analysis, or implemented a pre- or post- award review to ensure that contracting personnel completed the analyses. The report recommended that the Air Force Materiel Command direct the Air Logistics Centers to fully train officials on price analysis requirements and to establish internal control procedures over price analyses. The Air Force Materiel Command concurred with the recommendations, assessed training needs, and revamped the "Principles of Contract Pricing," training course with a renewed focus on price analysis techniques. Also, the Air Force Materiel Command revised its FAR Supplement 5315.808-91, "Post-Award Price Negotiation Memorandum Review," July 1, 1992, to establish clear requirements for price negotiation memorandum review, uniform pricing memorandum formats, and review checklists for use by all subordinate activities.

Appendix C. Summary of FY 1996 Contract Actions Reviewed

Military Departments

| Location | Contract Actions Reviewed | Total Negotiated Value | Price Analysis Performed Number | Price Analysis Performed Value | Price Analysis Required ¹ | | Cost Analysis Performed Number | Cost Analysis Performed Value | Negotiation Objective Basis Cost Price Analysis | | Cost or Pricing Data Provided Certified |
|---|---------------------------|------------------------|---------------------------------|--------------------------------|--------------------------------------|----------------------------------|--------------------------------|-------------------------------|---|-----------|---|
| | | | | | But Analysis Not Performed Number | But Analysis Not Performed Value | | | Cost Basis | Cost | |
| Army | | | | | | | | | | | |
| Aviation and Troop Command | 10 | \$ 2,600,826 | 9 | \$ 2,405,993 | 1 | \$194,833 | 2 | \$311,865 | 8 | 2 | 4 0 |
| Missile Command | 13 | 3,391,114 | 10 | 2,702,388 | 3 | 688,726 | 10 | 2,766,725 | 3 | 10 | 9 2 |
| Total Army | 23 | \$ 5,991,940 | 19 | \$ 5,108,381 | 4 | \$883,559 | 12 | \$ 3,073,590 | 11 | 12 | 13 2 |
| Navy | | | | | | | | | | | |
| Naval Sea Systems Command | 7 | \$ 1,869,381 | 2 | \$618,330 | 5 | \$1,251,051 | 6 | \$1,733,412 | 1 | 6 | 5 0 |
| Naval Inventory Control Point-Philadelphia | 12 | 4,647,698 | 11 | 4,271,862 | 1 | 375,836 | 2 | 687,574 | 10 | 2 | 6 1 |
| Supervisor of Shipbuilding, Conversion, and Repair, San Diego | 11 | 2,717,911 | 11 | 2,717,911 | 0 | 0 | 0 | 0 | 11 | 0 | 2 1 |
| Total Navy | 30 | \$ 9,234,990 | 24 | \$ 7,608,103 | 6 | \$1,626,887 | 8 | \$2,420,986 | 22 | 8 | 13 2 |
| Air Force | | | | | | | | | | | |
| Aeronautical Systems Center | 10 | \$ 2,572,710 | 7 | \$ 1,556,337 | 1 | \$ 242,500 | 3 | \$ 1,016,373 | 7 | 3 | 3 0 |
| Total Air Force | 10 | \$ 2,572,710 | 7 | \$ 1,556,337 | 1 | \$ 242,500 | 3 | \$ 1,016,373 | 7 | 3 | 3 0 |
| Total Military Departments | 63 | \$17,799,640 | 50 | \$14,272,821 | 11 | \$2,752,946 | 23 | \$6,515,949 | 40 | 23 | 29 4 |

¹Contracting officials did not perform price analysis for the 10 contract actions in which FPRA's or FPRR's were used.

²On certain contract actions, contracting officials performed a cost analysis and a price analysis.

³Normally, Defense Contract Audit Agency audits and certified cost or pricing data are not required for contract actions valued at less than \$500,000.

Appendix C. Summary of FY 1996 Contract Actions Reviewed

Defense Logistics Agency

| Location | Contract Actions Reviewed | Total Negotiated Value | Analysis Performed Number | Price Analysis Performed Value | Price Required 1 Analysis Required But Analysis Not Performed Number | Cost Analysis Performed Number | \$ Cost Analysis Performed Value | Negotiation Objective Basis | | Cost or Pricing Data Provided | Cost or Pricing Data Certified |
|--|---------------------------|------------------------|---------------------------|--------------------------------|--|--------------------------------|----------------------------------|-----------------------------|-----------|-------------------------------|--------------------------------|
| | | | | | | | | Price | Analysis | Price | Cost |
| Defense Contract Management Command, Atlanta | 3 | \$ 708,795 | 1 | \$ 132,084 | 2 | \$ 576,711 | 3 | \$ 708,795 | 0 | 3 | 3 |
| Defense Contract Management Command, El Segundo | 10 | 1,888,700 | 0 | 0 | 6 | 1,169,789 | 10 | 1,888,700 | 0 | 10 | 10 |
| Defense Contract Management Command, Lockheed Martin, Fort Worth | 9 | 2,380,983 | 4 | 776,783 | 1 | 434,000 | 8 | 2,272,233 | 1 | 8 | 9 |
| Defense Contract Management Command, Hughes, Los Angeles | 4 | 1,200,821 | 0 | N/A | 4 | 1,200,821 | 4 | 1,200,821 | 0 | 4 | 4 |
| Defense Contract Management Command, Northrop, Hawthorne | 12 | 3,068,302 | 12 | 3,068,302 | 0 | 0 | 0 | 0 | 12 | 0 | 7 |
| Defense Personnel Support Center | 7 | 2,242,745 | 7 | 2,242,745 | 0 | 0 | 0 | 0 | 7 | 0 | 0 |
| Total Defense Logistics Agency | 45 | \$11,490,346 | 24 | \$ 6,219,914 | 13 | \$ 3,381,321 | 25 | \$ 6,070,549 | 20 | 25 | 33 |
| | | | | | | | | | | | 5 |

¹Contracting officials did not perform price analysis for the 10 contract actions in which FPRAAs or FPRRs were used.

²On certain contract actions, contracting officials performed a cost analysis and a price analysis.

³Normally, Defense Contract Audit Agency audits and certified cost and pricing data are not required for contract actions valued at less than \$500,000.

Appendix C. Summary of FY 1996 Contract Actions Reviewed

FY 1996 Contract Action Summary Totals by Military Department and Defense Logistics Agency

| Location | Contract Actions Reviewed | Total Negotiated Value | Price Analysis Performed Number | Price Analysis Performed Value | Price Required ¹ | | Cost Analysis Performed ² | | Negotiation Objective Basis | | Cost or Pricing Data ³ Certified | |
|---|---------------------------|------------------------|---------------------------------|--------------------------------|-----------------------------|---------------------|--------------------------------------|----------------------|-----------------------------|-------------|---|------------|
| | | | | | But Not Performed | | Number | | Price Analysis | | Cost Analysis | |
| | | | | | Number | Value | Number | Value | Number | Value | Number | Value |
| Army | 23 | \$ 5,991,940 | 19 | \$ 5,108,381 | 4 | \$ 883,559 | 12 | \$ 3,078,590 | 11 | 12 | 13 | 2 |
| Navy | 30 | 9,234,990 | 24 | 7,608,103 | 6 | 1,626,887 | 8 | 2,420,986 | 22 | 8 | 13 | 2 |
| Air Force | 10 | 2,572,710 | 7 | 1,556,337 | 1 | 242,500 | 3 | 1,016,373 | 7 | 3 | 3 | 0 |
| Defense Logistics Agency | 45 | 11,490,346 | 24 | 6,219,914 | 13 | 3,381,321 | 25 | 6,070,549 | 20 | 25 | 33 | 5 |
| Summary Total of Contract Actions Reviewed | 108 | \$29,289,986 | 74 | \$ 20,492,735 | 24 | \$ 6,134,267 | 48 | \$ 12,586,498 | 60 | 48 | 62 | 9 |
| Percent of Contract Actions Reviewed | 100 | 100 | 68.5 | 70 | 22.2 | 20.9 | 44.4 | 43 | 55.6 | 44.4 | 57.4 | 8.3 |

¹Contracting officials did not perform price analysis for the 10 contract actions in which FPRAAs or FPRRs were used.

²On certain contract actions, contracting officials performed a cost analysis and a price analysis.

³Normally, Defense Contract Audit Agency audits and certified cost or pricing data are not required for contract actions valued at less than \$500,000.

Appendix D. Individual FY 1996 Contract Actions

Price Analysis Not Performed

| Location | Contract Action Number | Negotiated Value |
|--|-------------------------|------------------|
| Army | | |
| Aviation and Troop Command | DAAJ09-91-C-0175-P00146 | \$194,834 |
| Missile Command | DAAH01-93-G-0004-0025 | 184,950 |
| | DAAH01-92-C-0038-P00229 | 377,587 |
| | DAAH01-95-C-0095-P00034 | 126,189 |
| Navy | | |
| Naval Sea Systems Command | N00024-96-E-8102 | 199,373 |
| | N00024-94-C-4104-P00004 | 387,000 |
| | N00024-90-C-2312-P00029 | 207,965 |
| | N00024-90-C-2312-P00030 | 331,732 |
| | N00024-96-C-5205 | 124,980 |
| Naval Inventory Control Point-Philadelphia | N00383-95-G-018J-0002 | 375,836 |
| Air Force | | |
| Aeronautical Systems Center | F33600-96-D-0042-2001 | 242,500 |
| Defense Logistics Agency | | |
| Defense Contract Management Command, Atlanta | N00024-92-C-6202-A00092 | 349,870 |
| | N00024-92-C-6202-A00091 | 226,841 |
| Defense Contract Management Command, El Segundo | N00024-94-C-6201-A00004 | 160,000 |
| | N00104-86-G-A062-0007 | 144,463 |
| | N00024-93-G-5126-UG02 | 130,543 |
| | N00104-89-G-A014-0007 | 130,896 |
| | F04606-95-C-0023-PP0002 | 437,350 |
| | F04606-92-C-0159-PP0042 | 166,537 |
| Defense Contract Management Command, Lockheed Martin, Fort Worth | F42620-91-C-0569-A00105 | 434,000 |

Appendix D. Individual FY 1996 Contract Actions

| Location | Contract Action Number | Negotiated Value |
|--|----------------------------|---------------------|
| Defense Contract Management | | |
| Command, Hughes, Los Angeles | N00024-94-G-5200-XG15 | 282,600 |
| | N00019-90-G-0270-EX01 | 322,989 |
| | N00104-90-G-A031-XG4T | 463,000 |
| | N00104-90-G-A031-XG3G | 132,232 |
| Total Contract Actions and Negotiated Value | 24 Contract Actions | \$ 6,134,267 |

Cost Analysis Performed to Establish Negotiation Objective

| Location | Contract Action Number | Negotiated Value | Adequate Justification Provided |
|-------------------------------|---|--|---|
| Army | | | |
| Aviation and Troop Command | DAAJ09-95-C-0529 DAAJ09-91-C-0175-P00146 | \$ 117,032 194,833 | Yes No |
| Missile Command | DAAH01-96-C-0111 DAAH01-96-C-0281 DAAH01-96-C-0377 DAAH01-96-C-0104 DAAH01-96-C-0115 DAAH01-96-C-0199 DAAH01-96-C-0169 DAAH01-93-G-0004-0025 DAAH01-92-C-0038-P00229 DAAH01-95-C-0095-P00034 | 180,500 335,665 291,813 245,624 264,422 493,581 266,394 184,950 377,587 126,189 | Yes Yes Yes Yes Yes Yes Yes No No No |
| Navy | | | |
| Naval Sea Systems Command | N00024-96-E-8102 N00024-94-C-4104-P00004 N00024-96-C-5405 N00024-90-C-2312-P00029 N00024-90-C-2312-P00030 N00024-96-C-5205 | 199,374 387,000 482,361 207,965 331,732 124,980 | No No No No No No |
| Naval Inventory Control Point | N00383-96-C-P130 N00383-95-G-018J-0002 | 311,738 375,836 | Yes No |

Appendix D. Individual FY 1996 Contract Actions

| <u>Location</u> | <u>Contract Action Number</u> | <u>Negotiated Value</u> | <u>Adequate Justification Provided</u> |
|--|-------------------------------|-------------------------|--|
| Air Force | | | |
| Aeronautical Systems Center | F33657-92-C-2102-P00100 | 425,873 | Yes |
| | F3365794-D-2001-0022 | 348,000 | Yes |
| | F33600-96-D-0042-2001 | 242,500 | No |
| Defense Logistics Agency | | | |
| Defense Contract Management Command, Atlanta | N00024-92-C-6202-A00092 | 349,870 | No |
| | N00024-92-C-6202-A00091 | 226,841 | No |
| | N00104-90-G-A012-50031A | 132,084 | No |
| Defense Contract Management Command, El Segundo | N00030-96-G-0031-UG01 | 161,747 | Yes |
| | N00030-96-G-0031-UG07 | 147,449 | Yes |
| | N00383-93-G-010V-0006 | 151,226 | Yes |
| | N00383-93-G-010V-0012 | 258,489 | Yes |
| | F04606-92-C-0159-PP0042 | 166,537 | No |
| | F04606-95-C-0023-PP0002 | 437,350 | No |
| | N00024-94-C-6201-A00004 | 160,000 | No |
| | N00104-86-G-A062-0007 | 144,463 | No |
| | N00024-93-G-5126-UG02 | 130,543 | No |
| | N00104-89-G-A014-0007 | 130,896 | No |
| Defense Contract Management Command, Lockheed Martin, Fort Worth | F42620-91-C-0569-A00114 | 294,725 | Yes |
| | F42620-91-C-0569-A00117 | 119,111 | Yes |
| | F42620-91-C-0569-A00118 | 188,805 | Yes |
| | F42620-91-C-0569-A00119 | 302,170 | Yes |
| | F42620-91-C-0569-A00120 | 162,246 | Yes |
| | F42620-91-C-0569-A00123 | 386,676 | Yes |
| | F42600-89-C-0832-A00296 | 384,500 | Yes |
| | F42620-91-C-0569-A00105 | 434,000 | No |
| Defense Contract Management Command, Hughes, Los Angeles | N00024-94-G-5200-XG15 | 282,600 | No |
| | N00019-90-G-0270-EX01 | 322,989 | No |
| | N00104-90-G-A031-XG4T | 463,000 | No |
| | N00104-90-G-A031-XG3G | 132,232 | No |
| Total Contract Actions and Negotiated Value | 48 Contract Actions | \$12,586,498 | Yes = 22 No = 26 |

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
 Director of Defense Procurement
 Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
 Deputy Chief Financial Officer
 Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
 Defense Contract Management Command
Director, National Security Agency
 Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
 General Accounting Office

Appendix E. Report Distribution

Non-Defense Organizations and Individuals (cont'd)

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on National Security, Committee on Appropriations

House Committee on Government Reform and Oversight

House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform and Oversight

House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight

House Committee on National Security

Part III - Management Comments

Department of the Army Comments

inal Report
Reference



DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH DEVELOPMENT AND ACQUISITION
103 ARMY PENTAGON
WASHINGTON DC 20310-0103

25 JUL 1997

REPLY TO
ATTENTION OF

SARD-PP

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE, AUDITING, 400 ARMY NAVY
DRIVE, ARLINGTON, VA 22202-2884

SUBJECT: Audit Report on Contracting Officer Price Analysis
(Project No. 7CH-5004)

Provided herein are the Army comments on the subject audit report.

There are three Recommendations for Corrective action for the Acquisition Executives of the Army, Navy and Air Force and for the Director, Defense Logistics Agency (DLA).

a. Remind contracting officers to perform price analysis instead of using Defense Contract Audit Agency recommended rates, technical analysis, or field pricing support reports to evaluate contract proposal prices from \$100,000 to \$500,000.

The Army will remind contracting officers of the Federal Acquisition Regulation (FAR) 15.804-5 (1) requirement that they perform a price analysis to determine price reasonableness and any need for further negotiation if cost or pricing data are not required. While information other than cost or pricing data may be obtained, it will be used in conjunction with, and not in place of, price analysis.

b. Remind contracting officers to document price analysis performed in price negotiation memorandums. The Army will issue such a reminder.

c. Instruct contractors to provide certified cost or pricing data and other cost or pricing information only when requested.

It's not clear such an instruction is either necessary or a good idea. Contracting officers should be concerned with clearly telling offerors what information is wanted, and in keeping the information to a minimum. Any such instruction would logically take the form of a solicitation notice of some type. Rather than each Service and the DLA developing its own provision, if there is a need for this type of instruction it should be a

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Department of the Army Comments

- 2 -

standard provision in the FAR or Defense FAR Supplement. Therefore,
this recommendation should be directed to the Director, Defense
Procurement.

My action officer is Mr. Curtis Stevenson, 695-8476.



Edward G. Elgart
Acting Deputy Assistant Secretary of the
Army (Procurement)

Department of the Navy Comments

inal Report
Reference



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

AUG 5 1997

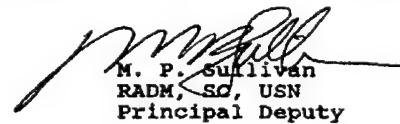
MEMORANDUM FOR OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT
OF DEFENSE

Subj: AUDIT REPORT ON CONTRACTING OFFICER PRICE ANALYSIS
(PROJECT NO. 7CH-5004)

Ref: (a) DoDIG memo dated 30 May 1997; same subject

Reference (a) forwarded Draft Audit Report 7CH-5004. Comments were requested indicating ASN(RD&A) position on three recommendations contained in the draft report. We agree with your recommendation that contracting officers should perform price analysis instead of using Defense Contract Audit Agency recommended rates, technical analysis, or field pricing support reports to evaluate contract proposal prices from \$100,000 to \$500,000. We also agree that contracting officers should document price analysis performed in price negotiation memorandums. Accordingly, we have issued policy guidance reminding our contracting activities of these regulatory requirements.

We do not agree with your recommendation that contracting officers should instruct contractors to provide certified cost or pricing data and other cost or pricing information only when requested. Under the Federal Acquisition Regulation (FAR), contractors are responsible for ensuring that proposed costs are adequately supported. While not encouraged, it is sometimes necessary and expected that contractors will provide information other than cost and pricing data when appropriate. Accordingly, since it is the responsibility of the contractors to sufficiently support their costs, we believe it should be left to their judgment to provide whatever information they deem necessary.



M. P. Sullivan
RADM, ~~Sc~~, USN
Principal Deputy

Department of the Air Force Comments



DEPARTMENT OF THE AIR FORCE
WASHINGTON DC



05 AUG 1997

OFFICE OF THE ASSISTANT SECRETARY

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

FROM: SAF/AQC
1060 Air Force Pentagon
Washington DC 20330-1060

SUBJECT: Draft Audit Report on Contracting Officer Price Analysis
Dated 30 May 1997, Report No. 7CH-5004

This is in reply to your memorandum requesting the Assistant Secretary of the Air Force (Financial Management and Comptroller) to provide Air Force comments on the subject report. As a result of discussions between Mr. R. Bemben of my staff and Mr. G. Stephenson and Mr. C. Hanshaw of the audit staff, the Air Force concurs with the intent of all recommendations. Although the Air Force believes the Federal Acquisition Regulation contains sufficient policy guidance, we acknowledge the need to continue educating both Government and industry personnel regarding changes to acquisition processes. Our detailed comments are attached.

We appreciate the opportunity to comment on this report.

TIMOTHY P. MALISHENKO, Brig Gen, USAF
Deputy Assistant Secretary (Contracting)
Assistant Secretary (Acquisition)

Attachment
Air Force Comments

Department of the Air Force Comments

inal Report
Reference

DEPARTMENT OF THE AIR FORCE RESPONSE
TO
DODIG DRAFT AUDIT REPORT OF 30 MAY 1997
ON
CONTRACTING OFFICER PRICE ANALYSIS
REPORT NO. 7CH-5004

Revised
Recommendation 1: We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to perform price analysis instead of using Defense Contract Audit Agency recommended rates, technical analysis, or field pricing support reports to evaluate contract proposal prices from \$100,000 to \$500,000.

Air Force Response: Concur with intent.

The Air Force agrees that, when possible, price analysis is preferable to cost analysis on those actions between \$100,000 and \$500,000 and we plan on issuing a memorandum reminding contracting officers of the hierarchical policy preference at FAR 15.802. However, we also note that the contracting officer is responsible for a determination regarding the reasonableness of a proposed price and must be able to exercise professional judgment in selecting pricing methodologies. In some cases, these methodologies include the analysis of cost data, technical reports, and analyses resulting from field pricing assistance. We do not believe it appropriate to completely preclude their use. Estimated completion date for this action is 30 Sep 97.

edirected
Recommendation 2: We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to document price analysis performed in price negotiation memorandums.

Air Force Response: Concur with intent.

The Air Force agrees that price analysis should be documented in the contract file. However, the audit report acknowledges on page 8 that the Air Force site examined (Aeronautical Systems Center) has "...consistently documented price analysis results in the prescribed sections of the negotiation memorandums." We believe, therefore, that additional policy guidance is not necessary.

Department of the Air Force Comments

Final Report
Reference

Recommendation 3: We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to instruct contractors to provide certified cost or pricing data or other cost or pricing information only when requested.

Deleted

Air Force Response: Concur with intent. Although it is ultimately the contractor's responsibility to provide sufficient information to support a proposed price, we agree that some contractors are still providing more information than necessary. This issue is an area of concern that is being addressed by the Air Force. Our plan is to issue a memorandum to contracting activities recommending they add this issue as an agenda item during their "Industry Days" and similar forums which are attended by both contractors and industry associations. We believe this will be more effective than requiring contracting officers to bring this problem to the attention of individual contractors. Estimated completion date for this action is 30 Sep 97.

2

Defense Logistics Agency Comments



IN REPLY
REFER TO

DDAI

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

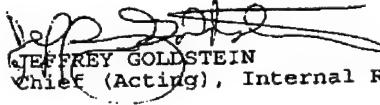
18 JUL 1997

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Contracting Officer Price Analysis
(Project No. 7CH-5004)

This is in response to your May 30, 1997, subject draft report. For any questions, call Dave Stumpf, 767-6266.

Encl


JEFFREY GOLDSTEIN
Chief (Acting), Internal Review

CC:
AQOD
AQBE

Defense Logistics Agency Comments

Final Report
Reference

AUDIT TITLE: Contracting Officer Price Analysis, 7CH-5004

18 JUL 1997

RECOMMENDATION 1: Recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to perform price analysis instead of using Defense Contract Audit Agency recommended rates, technical analysis, or field pricing support reports to evaluate contract proposal prices from \$100,000 to \$500,000.

Revised

DLA COMMENTS: Partially Concur.

Generally, proposals priced between \$100,000 and \$500,000 can, and should, be evaluated solely by using price analysis without resorting to an examination of the individual cost elements, i.e., cost analysis. But not always; FAR 15.804-2 allows cost or pricing data to be obtained under certain circumstances for proposals below \$500,000 provided that they exceed the simplified acquisition threshold (currently \$100,000). When cost analysis is required and audit, technical or other specific pricing assistance is necessary to support such analysis, it should be obtained.

Additionally, the recommendation, as written, seems to assume that technical and other pricing assistance is used only to support cost analysis. That is not true; such assistance may also be necessary when performing price analysis. For example, price analysis often involves comparing the proposed price of an item with a prior contract price for a similar item. Technical analyses often provide advice as to the degree of similarity between the two items and recommendations for adjustments in comparing the prices of the items. Such assistance may become increasingly common as the Department acquires more and more commercial items.

However, we do agree that price analysis alone should normally be used to evaluate proposals priced below \$500,000. Our existing policies clearly state that. In fact, we require our Administrative Contracting Officers to perform a price analysis for every contract pricing action regardless of dollar value and document the results (or provide rationale for not performing a price analysis) in negotiation memoranda. Since the audit found that this requirement was not being followed by all of our contract administration offices, we will issue a letter to our offices reminding them of those requirements.

DISPOSITION: Action is Ongoing. ECD: September 30, 1997

ACTION OFFICER: David Ricci, AQOD, 703.767.3376

APPROVAL: Gary Thurber, Associate Director, DCMC, 9 Jul 97

COORDINATION: Robert L. Molino, Executive Director, Procurement

D. Stumpf, DDAI *7-18/97*

DLA APPROVAL:

Ray E. McCoy
RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Logistics Agency Comments

18 JUL 1997

AUDIT TITLE: Contracting Officer Price Analysis, 7CH-5004

RECOMMENDATION 2: Recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to document price analysis performed in price negotiation memorandums.

DLA COMMENTS: Concur.

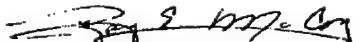
We already require documentation of the price analysis performed in negotiation memoranda as stated in our response to Recommendation 1. Since the audit found that our contract administration offices were not fully complying with this requirement, we will issue a letter to our offices reminding them of this requirement.

DISPOSITION: Action is Ongoing. ECD: September 30, 1997

ACTION OFFICER: David Ricci, AQOD, 703.767.3376

COORDINATION: Robert L. Molino, Executive Director, Procurement
D. Stumpf, DDAI 80 7/16/97

DLA APPROVAL:


RAY E. MCCOY
Major General, USA
Principal Deputy Director

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RECOMMENDATION 3: Recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to instruct contractors to provide certified cost or pricing data and other cost or pricing information only when requested.

Deleted

DLA COMMENTS: Nonconcur. The audit found that contracting officers requested cost or pricing data only when required. The recommendation apparently addresses the situation where contractors submit cost or pricing data or information other than cost or pricing data in support of their proposed prices when submission of such data is neither required by law nor requested by the contracting officer. We assume that this recommendation is predicated on the statement (Page 10 of draft report) that contractor provision of unnecessary data increases contractor overhead costs, which are normally charged to the Government." However, the audit report did not provide any estimates of the savings that would result from the recommendation. Actually, we believe that any reduction in proposal preparation costs from adopting this recommendation would be minimal at best and insignificant in relation to other overhead costs. (In other words, contract prices would be unaffected.) Also, if a contractor chooses to submit some additional information, beyond that requested by the contracting officer, to demonstrate the reasonableness of the proposed price, we shouldn't prohibit the contractor from submitting it--especially since the incremental costs to the Government are at most negligible and probably nonexistent.

DISPOSITION: Action is considered complete

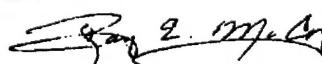
ACTION OFFICER: David Ricci, AQOD, 703.767.3376

APPROVAL: Gary Thurber, Associate Director, DCMC 9 Jul 97

COORDINATION: Robert L. Molino, Executive Director, Procurement

D. Stumpf, DDAI 82-7/19/97

DLA APPROVAL:



RAY E. MCCOY
Major General, USA
Principal Deputy Director

Defense Contract Audit Agency Comments

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Reference



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

PFC 225.4

29 July 1997

MEMORANDUM FOR DOD INSPECTOR GENERAL (DODIG), CONTRACT MANAGEMENT DIRECTORATE

SUBJECT: Audit Report on Contracting Officer Price Analysis (Project No. 7CH-5004)

We have reviewed the subject draft report as requested by your 30 May 1997 memorandum. While there are no recommendations directed to DCAA, we offer the following responses to recommendation numbers 1 and 3:

Recommendation: We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition); Assistant Secretary of the Navy (Research, Development, and Acquisition); Assistant Secretary of the Air Force (Acquisition); and the Director, Defense Logistics Agency, issue policy guidance to their contracting organizations requiring contracting officers to:

1. Perform price analysis instead of using Defense Contract Audit Agency recommended rates, technical analysis, or field pricing support reports to evaluate contract proposal prices from \$100,000 to \$500,000.

DCAA Comments:

We agree that most pricing actions from \$100,000 to \$500,000 should be evaluated using price analysis. However, there are instances when paragraph (b) of FAR 15.805-5, Field pricing support, provides for requesting field pricing support for proposed contracts or modifications less than \$500,000. This occurs when a contracting officer can not establish a reasonable price because of:

- (1) lack of knowledge of the particular contractor
- (2) sensitive conditions
- (3) an inability to evaluate the price reasonableness through price analysis or cost analysis of existing data

Paragraph (a) of FAR 15.804-5, Requiring information other than cost or pricing data, requires that price analysis be performed if cost or pricing data are not required because an exception applies, or an action is at or below the cost or pricing threshold. However, FAR 15.504-5 does not prohibit conduct of a cost analysis in those circumstance cited in FAR 15.805-5(b). Therefore, we recommend that cost analysis and use of DCAA

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SUBJECT: Audit Report on Contracting Officer Price Analysis (Project No. 7CH-5004)

recommended rates be allowed as tools in the limited circumstances cited in FAR 15.805-5(b).

3. Instruct contractors to provide certified cost or pricing data and other cost or pricing information only when requested.

Deleted

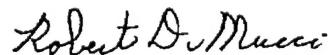
DCAA Comments:

An offeror's proposal represents the information that the offeror believes is necessary to best present its offer to the government in a clear and concise manner. Government officials who are responsible for negotiating a fair and reasonable price should not prohibit the offeror from providing information which it believes necessary to ensure that the proposed offer is clearly communicated.

While there may be concern that the creation of such information increases contractor overhead costs unnecessarily, it should be noted that the information was created not at the request of the government, but because the contractor felt such data was required in order to adequately develop its offer. As long as it is the government's policy to reimburse contractors for reasonable bid preparation costs, an order to contractors not to provide any information generated (or an order to contracting officers not to look at information that is provided) is not likely to materially reduce the incurrence of these costs.

FAR 15.802 already requires that the contracting officer shall not obtain more information than is necessary, and places limits on the information that the contacting officer may request. Therefore, we do not believe that this recommendation is necessary given the policy in FAR 15.802.

Questions may be addressed to Ms. Joyce Friedland, Program Manager; Pricing Finance and Claims Division, at (703) 767-2270.



For Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

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